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No. 152

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1927

F. H. MASON,

Petitioner,

against

C. F. ROUTZAHN, *Collector of Internal Revenue* for the Eighteenth District of Ohio,

Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Motion for Leave to File a Brief

and

Brief Submitted by Leave of Court

CHARLES E. HUGHES,
EDWARD CORNELL,
WILLIAM C. BREED,
PAUL ARMITAGE,
HARRISON TWEED,
Amici Curiae.

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MOTION FOR LEAVE TO FILE A BRIEF and BRIEF SUBMITTED BY LEAVE OF COURT.

MOTION.

Now come Charles E. Hughes, Edward Cornell, William C. Breed, Paul Armitage and Harrison Tweed, attorneys and counsellors of this Court, and represent that there is involved in this case a question in which they are interested on behalf of clients who have cases pending in the courts and in the Bureau of Internal Revenue, in which

dividends received during the year 1917 were declared by the board of directors of the corporation on one date and physically paid to the stockholders on a later date. The question in issue is what years' rates of taxation should be applied. In most of these cases the dividend was both declared and paid within the year 1917. In some of them, however, the dividend was declared in 1916 and paid in 1917. In both classes of cases the question is precisely the same and its determination depends upon the same considerations. The question is, however, seen more clearly if it is considered from the point of view of a case in which the dividend was both declared and paid within the year 1917.

The answer involves the interpretation of Section 31 of the Revenue Act of 1917, which is before the Court in the case at bar.

Therefore, as *amici curiae* in support of the position of the petitioner, they pray leave to file a brief in the following form:

ARGUMENT.

The Question Involved.

We shall not discuss in this brief the contention of the Government that the phrase "most recently accumulated undivided profits or surplus" refers to the profits which are finally ascertained and entered as the profits of the entire year in which the dividend is paid, because we believe that that contention is foreclosed by the decision of this Court in *Edwards* v. *Douglas*, 269 U. S. 204, and, in any event, is fully covered in the main brief filed in this case.

Section 31 of the Revenue Act of 1917, which is set forth in full in Appendix A, lays down three rules for the taxation of a dividend distribution:

> First, relating to income: That the dividend shall constitute a part of the income of the stockholder "for the year in which received" by him.
>
> Second, relating to the tax rate: That the dividend shall be taxed at the rate prevailing during the year in which the profits distributed "were accumulated by the corporation."
>
> Third, relating to the order of distribution of profits: That in determining what years' profits are distributed, the dividend "shall be deemed to have been made from the most recently accumulated undivided profits or surplus."

The question which arises can be best illustrated by an assumed case:

On February 1, 1917, the board of directors of a corporation declared a dividend the total amount of which was $100,000, payable on March 1 to stockholders of record on February 15. On December 31, 1916, the corporation had undivided profits and surplus of $1,000,000, of which $100,000 was earned during the year 1916. During January, 1917, it had neither profits nor losses. Between February 1 and March 1 it had profits of $100,000, so that the total undivided profits and surplus on the latter date was $1,100,000. On February 1 the amount of the dividend was charged against undivided profits and surplus and set up on the books as a liability to the stockholders. On March 1, the dividend checks, which in the meanwhile had been drawn, were mailed to the stockholders. Is the dividend

taxable at the rates applicable for the year 1917 or at the rates applicable for the year 1916?

What does the statute say? It says that a dividend is to be taxed at the rate prevailing during the year in which the profits distributed "were accumulated by the corporation." It says further that in determining what years' profits are distributed, the dividend "shall be deemed to have been made from the most recently accumulated undivided profits or surplus." It is perfectly clear that if the dividend is to be deemed to have been made from the $1,000,000 fund of undivided profits and surplus accumulated when it was declared on February 1, *the part* of that fund distributed by the dividend is the $100,000 earned in 1916. It is equally clear that if the dividend is to be deemed to have been made from the $1,100,000 fund of undivided profits on hand when the dividend checks were mailed on March 1, *the part* of that fund distributed is the $100,000 earned in February, 1917. There can be no question about this, for it is expressly covered by the wording of the statute. But is the dividend to be deemed to have been made from the $1,000,000 fund existing when the dividend was *declared,* or from the $1,100,000 fund existing when the dividend was *paid?* The issue is whether the profits earned after the declaration of a dividend and before its payment are to be included in the conglomerate fund of profits from which the dividend distribution is deemed to have been made. Or, to put it in another way, the issue is whether the fund out of which a dividend distribution is made is to be determined as of the date of declaration or as of the date of payment of the dividend.

The statute does not expressly specify as of what date the "most recently accumulated undivided profits or surplus" are to be determined.

In the first place it is clear that Congress has not expressly stated that profits earned *after* the declaration of a dividend are to be included in the conglomerate fund of profits from which the dividend distribution is deemed to have been made, and that the obligation is upon the courts to give a reasonable construction to the statute. Congress might, of course, have so stated by merely adding at the end of the phrase "most recently accumulated undivided profits or surplus" the words "determined as of the date of the *payment* of the dividend." But this is just what Congress did not do.

The Government admits that this is so when it argues that the date for determining the profits constituting the source of a dividend is either (a) the last day of the year in which the dividend is paid, or (b) the day on which in the following year the stockholder makes up his income tax return. Obviously, the Government could not make such an argument if the statute contained an express statement that the date for such determination is the date of the payment of the dividend. In making this argument the Government must be deemed to concede that Congress has not expressly specified a date for the determination. This is a concession which in view of the language of the statute, the Government cannot avoid.

A careful reading of subdivision (b) shows that it has not said as of what date the "most recently accumulated undivided profits or surplus" should be ascertained. It has merely said that "any distribution * * * shall be

deemed to have been made from the most recently accumulated undivided profits or surplus" and has remained silent as to the date for determining what are the "most recently accumulated undivided profits or surplus." It has not even said that the determination shall be made as of the time "when the distribution is made," whatever that phrase would have meant. Therefore, the Government would accomplish very little by establishing its contention that the words "distribution made" mean "dividend paid." The most that the statute would then say would be that a "dividend shall be deemed to have been *paid* out of the most recently accumulated undivided profits or surplus," but it would still remain silent as to the date for determining what are the "most recently accumulated undivided profits or surplus" distributed by the dividend.

Once it be admitted that Congress has not specified in Section 31 (b) the date or point of time for determining the profits constituting the source of a dividend, the question of what interpretation is to be placed upon the phrase "distribution made" becomes immaterial. If the words "any distribution made to shareholders" are not used to specify the date when the conglomerate fund of undivided profits or surplus is to be fixed, it does not matter whether the phrase "distribution made" means "dividend declared" or "dividend paid." Under such circumstances the date for the determination of the fund of which the dividend is a distribution must be sought *dehors* the statute, because, *ex concesso,* Congress has not expressly specified that date in the statute itself.

The failure of Congress to specify a date for determining the conglomerate fund of profits constituting the source of the dividend is conclusive that it intended to leave the selection of that date just where it found it, and that the selection should be made in accordance with good accounting practice, charter provisions fixing dividend dates and the rules of corporate and criminal law.

Do these rules declare that the conglomerate fund of profits from which a dividend distribution is made is the fund existing when the dividend is declared or the fund arising thereafter and existing when the dividend is paid? There can be no doubt of the answer. The corporate profits which are available for dividend distribution are those which exist at the time that the dividend is declared. It is unlawful to declare a dividend unless profits then exist. In most states it is a penal offense (see, for example, N. Y. Stock Corporation Law, Sec. 58; New York Penal Law, Sec. 664; *Liebman* v. *Auto Strop Co.*, 241 N. Y. 427). It is, therefore, to the profits existing when the directors meet that they must look to ascertain their right to declare a dividend, and to decide whether to do so. It is against the fund of profits then existing that the dividend is charged. When a dividend has been declared, the amount thereof is immediately debited against current undivided profits or accumulated surplus of preceding years. Sometimes, a dividend account is opened and when the dividend is declared its amount is set up as a credit to that account, and later, when the dividend is paid, debited to that account. But however the books are kept,

the charge against profits is always made or becomes a liability at the time of the declaration of the dividend, and it is obvious that the dividend can never, as a matter of bookkeeping, be charged against profits accumulated subsequent to the declaration of the dividend. *Nor is the method of handling the entries on the books of the corporation a mere matter of bookkeeping. The entries made reflect the underlying legal situation created by the declaration of the dividend.*

When a dividend is declared, the relation of debtor and creditor is immediately created as between the corporation and the stockholder. Money of the corporation is by the act of the directors in declaring the dividend segregated from the accumulated surplus and undivided profits existing at the time of the declaration of the dividend and appropriated to its payment. Sometimes the form of the declaration is such that this appropriation amounts to more than the creation of the relation of debtor and creditor, and a trust fund is set up for the benefit of the stockholders, to which their claim has priority over the claim of other creditors. In the court below the Government affirmatively admitted each of these propositions. It could hardly do otherwise in view of the decision in *United States* v. *Guinzburg*, 278 Fed. 353, and a multitude of other cases.

In the *Guinzburg* case the Circuit Court of Appeals held that a dividend declared on February 17, 1913, and payable July 1, 1913, was not taxable as income, saying:

> "We think that the dividend declared prior to March 1, 1913, the effective date of the Income Tax Act here considered, was not income when paid because it was part of the capital of the defendant in

error on March 1, 1913. By the declaration of a dividend, the earnings of the company to the extent declared were separated from the property of the corporation, and were appropriated by that action to the then stockholders, who became creditors of the corporation for the amount of the dividend. The relation then created was that of debtor and creditor. (Citing cases.) It is the separation of the earnings from the balance of the corporate property, together with the promise to pay arising from the declaration of the dividend, that works this change. The holder of stock, with respect to the dividend, is on a par with the other creditors of the corporation. *Staats* v. *Biograph Co.*, 236 Fed. 454, 149, C. C. A. 506, L. R. A. 1917B, 728. The fact that the dividend is payable at a future date does not alter the rights thus created. The obligation of the corporation as debtor commences with the declaration of the dividend, although the payment is postponed for the convenience of the company. The rights of the stockholders are immediately vested the moment the dividend is declared. *N. Y. Trust Co.* v. *Edwards, supra.* The action of the board of directors is the appropriation of a portion of the earnings to the defendant in error as the holder of a certificate of stock."

These principles have been recognized by this Court over and over again (see *Lynch* v. *Hornby*, 247 U. S. 339, 353, and *Eisner* v. *Macomber*, 252 U. S. 189, 219).

The date of the payment of a dividend is one which has no logical connection whatever with the actual and legal source of the dividend. The payment of a dividend is merely a clerical and ministerial act whereby checks are mailed to the stockholders. No book entry is made at that time, except one whereby the liability created by the declaration of the dividend is washed out just as any other liability is washed out on the books when paid.

The fact is that the only reason why a dividend is not paid on the day it is declared is one of convenience. Originally, and, in the case of small corporations, even today, the dividend checks are drawn on the day of the declaration of the dividend. In the case of large corporations the practice has grown up of postponing the payment as a matter of convenience. One reason why it is convenient to postpone payment is the amount of labor involved in drawing the checks. It would be physically impossible to draw the necessary number of checks and have them signed on the day that the dividend is declared. Another reason for the postponement is that it is considered desirable to give stockholders and prospective purchasers of stock advance notice of the dividend so that the stock may be bought and sold upon the basis of the approaching dividend. Thus the custom is for the board of directors to designate not only a future date for payment, but also a date as of which the registered stockholders shall be the persons entitled to receive the dividend. For example, a large corporation might declare a dividend on February 1, payable on March 1, to stockholders of record on February 15. Thus, notice is given that any purchaser of the stock who does not present his certificate for transfer on February 15 will not be entitled to receive the dividend. In order to clearly fix the respective rights of the purchaser and the seller, the New York Stock Exchange requires delivery of stock certificates to the purchaser on the day of the sale. Therefore, a purchaser of stock on February 14 could, but a purchaser on February 15 could not, present his certificate for transfer in time to become entitled to the dividend. On February 15 the stock would sell on

the Stock Exchange "ex dividend", that is to say, the purchaser on or after that day is not entitled to the dividend. On that day the stock ordinarily sells at a price which is lower by the amount of the dividend.

The importance of this procedure is two-fold. First, it indicates that the postponement of the payment of the dividend is not a matter of substance, but merely of convenience, and that what happens when the dividend is paid is nothing more than the performance of the ministerial duty of drawing and mailing the dividend checks. Second, the procedure discloses that the Government's argument that the words "distribution made" mean "dividend ~~declared~~ paid" leads to an absurdity. The statute includes only distributions "made to the shareholders". If these words mean "paid to the shareholders", then they exclude a dividend received by the seller of stock "ex dividend", for, though he is a shareholder at the time the dividend is declared, he is not a shareholder when the dividend is paid and the transfer has been made on the books of the corporation.

When we come to consider the circumstances under which Section 31(b) was enacted and the purposes which Congress had in mind, it becomes clear that there is no reason for a departure from, but rather a necessity for an adherence to, established rules of law and accounting for determining the source of a dividend. These circumstances and purposes are clearly pointed out in the opinion of Mr. Justice Brandeis in *Edwards* v. *Douglas*, 269 U. S. 204, 211. It is clear that the main purpose of Congress was to provide that, subject only to the conclusive presumption of distribution in the inverse order of

accumulation, a dividend should be taxed at the rate applicable to the year in which the profits which it *in fact* distributed had been accumulated by the corporation, so that war earnings, and war earnings only, should be taxed at war rates. The Government seeks to defeat this purpose by setting up an arbitrary and illogical test for determining what profits are distributed by a given dividend —a test whereby the profits deemed to be distributed are profits which did not exist when the dividend was declared and when the right of the stockholder to receive the dividend became fixed and irrevocable. In doing so, it ignores the controlling consideration that the statute must be construed in the light of the corporate facts to which it applies.

The words used by Congress are entirely appropriate to express its purpose.

Congress said that "any distribution made to the shareholders or members of a corporation * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus". It used the phrase "distribution made" because that was the natural and normal and, perhaps, the only phrase to use. It could not use the phrase "dividend paid" or "dividend declared" because the use of the word "dividend" would have brought into play the definition of a dividend contained in subdivision (a). If in subdivision (b) Congress had referred to "any dividend paid" or "any dividend declared", the word "dividend" would have been cut down in its meaning by the definition in sub-

division (a) so as to include only distributions made or ordered to be made out of profits accrued *since* March 1, 1913. In other words, a dividend which by special resolution of the board of directors was payable out of profits accrued *prior* to March 1, 1913, would not have come within the provisions of subdivision (b). Clearly, Congress did not wish to exclude such dividends from the provisions of subdivision (b). Therefore, it used the word "distribution" instead of the word "dividend", and selected the verb appropriate to the noun "distribution". A distribution, unlike a dividend, is not declared or paid, but is *made*.

Now, when Congress said that a "distribution * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus", did it intend to fly in the face of corporate law and practice and instead of permitting that law and practice to designate as the source of the dividend the profits on hand at the time of the declaration, arbitrarily to lay down an utterly inconsistent rule designating as the source of the dividend the profits on hand when the dividend was paid? We doubt whether, even if Congress had used the phrase "dividend paid" instead of the phrase "distribution made", such an intention could fairly have been attributable to it. It would have required something more than this general reference to the payment of a dividend—something in the nature of a specific reference to the profits "existing as of the date of the payment of the dividend"—to justify the conclusion that Congress so intended.

But Congress did not use the phrase "dividend paid". It used the more generic and broader phrase "distribution made". That it did not attach to that phrase the

meaning "dividend paid", is clear from the use of the same phrase in the proviso at the end of subdivision (b), which reads:

> "This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

The purpose of this proviso was to keep faith with the stockholders of corporations the directors of which, in reliance upon the existing law and before they had notice of the proposed change in the law, had expressly declared a dividend to be payable out of surplus existing on March 1, 1913. Congress said that that notice had been given on August 6, 1917. It said that any 'distribution made" prior to that date out of surplus existing on March 1, 1913, should not be affected by the amendment. Did it mean dividends which had been declared or dividends which had been paid before August 6th? Clearly, it must have meant dividends *declared* before that date. It was thinking not of the receipt of dividends by the stockholders or the paying out of the money by the corporation. It was thinking of the action of the directors in declaring a dividend expressly payable out of surplus existing on March 1, 1913. Therefore, when it referred to a distribution made, it must have referred to that part of the transaction which takes place when the board of directors separates a part of the undivided profits or surplus from the property of the corporation and appropriates it to the stockholders. Otherwise the purpose of Congress would in many cases be frustrated. A dividend declared on August 1 and payable on

August 15 was as much entitled to exclusion from the amendment as one declared on August 1 and payable on August 5. The distinction to be drawn was not between dates of payment, but between dates of declaration. Every dividend declared prior to August 6 was entitled to exemption. Every dividend declared after that date was properly to be subjected to the new rule of taxation. For purposes of keeping faith and being fair to stockholders, the thing which Congress intended to accomplish was the exclusion from the amendment of every dividend with respect to which action had been taken in reliance upon the then existing rules for taxation before Congress had given notice of its intention to change those rules. It cannot be questioned that that action is taken when a dividend is declared. Therefore, in that context the phrase conveys the thought and refers to the time of the declaration of the dividend.

The Board of Tax Appeals has held in *Appeal of Stange*, 1 B. T. A. 810 (1925), that a dividend declared prior to August 6, 1917, but not paid until after that date, comes within the proviso to subdivision (b) of Section 31 because the phrase "distribution made" refers to the date of the declaration of the dividend. In the opinion of the Board of Tax Appeals it is stated:

> "The determination of the principal question herein depends, in the last analysis, upon the construction which must be given to the words *any distribution made*, as used in section 31 (b) of the Revenue Act of 1916. If these words have reference to the declaration of a dividend, the taxpayer must prevail; if they mean the actual time of payment of a dividend, then it will be necessary to construe the limitations upon distribution of earnings and profits in said section. It

is therefore necessary to ascertain the legal effect of a resolution declaring a dividend. The definition of a dividend in section 31 (a) of the 1916 Act as 'any distribution made or ordered to be made by a corporation * * * out of its earnings or profits * * * and payable to its shareholders,' comports with the general definition of a dividend, and for the purposes of this case may be taken as correctly defining a dividend declared out of earnings or profits accrued prior to March 1, 1913. What, then, is the legal effect of the declaration of a dividend?

* * * * * * * *

The outstanding features of a dividend declaration are that, by the mere declaration, the dividend becomes thereby separated and segregated from the stock and exists independently of it; the *right* thereto becomes immediately fixed and absolute in the stockholders, and the corporation becomes a debtor to its stockholders for their pro rata shares. There is an apportionment or division of the assets of the corporation, to the extent of the dividend, to its stockholders. The corporation is at once poorer in the amount of the dividend declaration, and the stockholder becomes richer in his own right, to the extent of his pro rata share. What theretofore existed as undivided profits or surplus has become divided profits and the surplus is reduced to the extent of the dividend declared. It has ceased to be the property of the corporation and has become the property of the stockholder, and his interest therein becomes adverse to the corporation and to every other stockholder. We think this division or segregation of the amount of the dividend from the general mass of the corporate property and its apportionment to the stockholders is included in the words *any distribution made*, as used in the statute, and that those words must be given the same legal effect as results from the declaration of a dividend. It follows that the resolution of the board of directors of A. H. Stange Co., passed on January 27, 1917, con-

stituted a distribution to its stockholders at that time of the surplus existing at March 1, 1913, and the fact that payment was made in subsequent years becomes immaterial.

It remains to apply the provisions of section 31 (b) of the 1916 Act. By that section any distribution made in the year 1917 or subsequent tax years is deemed to have been made from the most recently accumulated and undivided profits or surplus, and the presumption thus raised has been held to be a conclusive presumption. *Harder* v. *Irwin*, 285 Fed. 402; *Douglas* v. *Edwards*, 298 Fed. 229. The facts herein show that A. H. Stange Co. had operated at a loss in all the years from 1912 to 1917, and there were no undivided profits since 1913 out of which a distribution could have been made, and this appeal could be sustained on that ground. We prefer, however, to rest our decision upon the last sentence of section 31 (b), providing:

> This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

Holding, as we do, that the words *any distribution made*, as used in the statute, include the declaration of a dividend and must have the same legal effect; and the dividend in question having been declared prior to August 6, 1917, to wit, on January 27, 1917, the presumption that the distribution was from the most recently accumulated undivided profits or surplus has no application to the facts in this appeal. We are of opinion that the distribution made by the A. H. Stange Co. to its stockholders on January 27, 1917, out of a surplus existing prior to March 1, 1913, is exempt from taxation to the taxpayer herein at the time of the actual payment, and the determination of the Commissioner proposing to tax the same in the years in which it was paid must be disapproved."

This decision was at first acquiesced in by the Treasury Department, although subsequently its acquiescence was withdrawn, presumably because it appreciated that such acquiescence was inconsistent with the position it is taking in the present case.

The Board of Tax Appeals has also held in a case where the dividends were declared in January, 1917, and paid at a later date, that the phrase "distribution made" refers to the time of the declaration and not to the time of the payment of a dividend, and that, therefore, the fund from which the dividend is deemed to have been distributed consists of the profits existing at the time of the declaration of the dividend (*Appeal of Hendricks*, 4 B. T. A. 1257). The opinion states:

> "We therefore hold that the resolution of the board of directors of Hendricks Brothers, Inc., of January 17, 1917, constituted a dividend at that time, regardless of the fact that part of the dividend was not paid until later. * * * it follows, therefore, that the distribution made by Hendricks Brothers, Inc., on January 17, 1917, was made from earnings for the period January 1 to January 17, 1917, in so far as there were such earnings."

The same decision was made by the Board of Tax Appeals in *Appeal of Stranahan* (Corporation Trust Company's Federal Tax Service, 1926, Part I, Board of Tax Appeals, Page 403).

There is every reason why the words "distribution made," as used to designate the part of the conglomerate fund from which the distribution should be deemed to have been made, should be construed to speak as of the date of

the declaration of the dividend and to refer to the profits then most recently accumulated. The purpose of the provision was to eliminate the right of the board of directors to declare by express resolution that a dividend was to constitute a distribution of the profits of a specified year, and to substitute for that right a conclusive presumption of fact and law. In accomplishing that purpose the mind of Congress was focussed upon the action of the board of directors in declaring a dividend, and the words it used speak as of that time. That is the time as of which the source of a dividend would be fixed by express resolution of the board of directors, and that is the time as of which it would properly be fixed by the conclusive presumption which Congress created. Furthermore, as the Government and the Circuit Court of Appeals frankly admitted, that is the time as of which the respective rights of the corporation and the stockholder are fixed. It is then that the distribution is made to the shareholders in every substantial sense, and there remains only the ministerial duty of drawing and mailing the checks.

In the Court below the Government attempted to give to the phrase "distribution made" the meaning "dividend paid" by calling attention to the words "made or ordered to be made" in qualification of the word "distribution" in subdivision (a). It attached to these words the significance "declared or paid." Upon this premise it built the argument that the omission of the words "ordered to be made" in subdivision (b) indicated an intention by Congress to refer to the time of payment, as distinguished from the time of declaration, of a dividend. The truth of the matter

is that the words "made or ordered to be made" in subdivision (a) were not used with the meaning "declared or paid."

Subdivision (a) of Section 31 was inserted in the original Revenue Act of 1916 in order, as Mr. Justice Brandeis has pointed out in *Edwards* v. *Douglas*, 269 U. S. 204, 212, to make it clear that dividends paid out of profits earned before March 1, 1913, should not be subject to income tax. To do this it was necessary appropriately to define "dividends." Congress accordingly said:

> "That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, * * *."

It is unquestionable that the words "made or ordered to be made" were used to make clear that there was to be included within the definition of a taxable dividend two distinct varieties of dividends. The first variety was "any distribution made * * * by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen," and *not* made payable out of the profits of a specified year by an express resolution of the board of directors. The second variety was "any distribution * * * *ordered to be made* by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen," by an express resolution of the board of directors. The use of these words in the definition of a taxable dividend had also the further effect of excluding a dividend specifically made payable

out of earnings accrued *prior* to March 1, 1913, by an express resolution of the board of directors. It was appropriate, if not, indeed, necessary, that the definition should make this inclusion and exclusion. The custom had already grown up of designating the source of a dividend by resolution of the board of directors, and Congress wished to make it clear that that practice might be continued and that it would be effectual.

Proof that this was the purpose of Congress is furnished by the language used in subdivision (a) of Section 201 of the Revenue Act of 1918. In that Act, Congress created a conclusive presumption that a dividend should be deemed to have been made from profits accumulated since March 1, 1913, thereby depriving the board of directors of the right to specify the source of the dividend, and bringing it about that profits accumulated before that date could not be distributed tax exempt until all subsequent profits had been distributed. In the definition of a dividend inserted in that Act, Congress omitted the phrase "ordered to be made" and referred only to "any distribution made by a corporation * * * out of its earnings or profits accumulated since February 28, 1913." It realized that if it left in the phrase "ordered to be made," there would have been an inconsistency between the conclusive presumption it was creating and the definition of a taxable dividend it was establishing.

This explanation of the correct meaning of the words "made or ordered to be made" would seem to be a complete answer to the main argument made by the Government in the Court below.

Another argument which the Government advanced was

that since Section 31 (b) is a part of an income tax statute, the words "distribution made" must be read in the sense of "dividend paid" because, until a dividend is physically paid, it does not constitute income of the stockholders. To construe the phrase "distribution made" otherwise, it was argued, would render the section meaningless and inapt in a statute taxing only dividends "when paid". The fallacy in this argument is that the context in which the words are used has nothing to do with the question of taxable income. The important phrase is "any distribution * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus". This phrase was not intended to designate what is income of the stockholder, for that was accomplished when, in an earlier part of the section, it was said that a dividend "shall constitute a part of the annual income of the distributee for the year in which received". On the contrary, the phrase was intended to designate the part of the composite fund of profits which should be deemed to have been distributed by the dividend. The point which Congress was there covering does not concern what is income for purposes of taxation, but what profits are distributed by a dividend. That is a matter involving corporation law rather than the law of income taxation and the Government and the Circuit Court of Appeals frankly admitted that as between the corporation and the stockholder the declaration of a dividend constitutes the distribution.

As already stated, we think that whatever meaning may be attached to the words "distribution made", it still remains clear that Congress has not specified that the con-

glomerate fund of profits out of which a dividend distribution is made, shall be determined as of the date of the *payment* of a dividend. In the absence of such specification, a court of construction must infer that Congress intended that there should be applied the accepted and logical rule of corporation law, that the determination is made as of the time of the *declaration* of the dividend. To adopt the novel and arbitrary rule for which the Government contends, would be to read into the statute something which is not there and which Congress would have put there if it had intended that that rule should apply. Furthermore, to read that rule into the statute would be to attribute to Congress the intent to cause many practical absurdities and to create conflict with good accounting practice and the established rules of corporation and criminal law.

Respectfully submitted,

CHARLES E. HUGHES,
EDWARD CORNELL,
WILLIAM C. BREED,
PAUL ARMITAGE,
HARRISON TWEED,
Amici Curiae.

APPENDIX A.

Section 31 of the Revenue Act of 1916 as amended by the Act of October 3, 1917, reads as follows:

"Sec. 31. (a) That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association or insurance company; which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

Office Supreme Court, U.S.
FILED
OCT 6 1927
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

NO. [redacted] 152

F. H. MASON, Petitioner,

Against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio, Respondent.

BRIEF SUBMITTED BY LEAVE OF COURT.

JAMES E. MacCLOSKEY, JR.,
Amicus Curiae.

1323 Farmers Bank Building,
Pittsburgh, Pa.

SMITH BROS. CO. INC., LAW PRINTERS, 208-212 GRANT ST., PITTSBURGH, PA.

IN THE

Supreme Court of the United States

NO. 770.

F. H. MASON, Petitioner,

Against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio, Respondent.

Brief Submitted by Leave of Court.

By JAMES E. MACCLOSKEY, JR., *Amicus Curiae.*

Why did Congress adopt so peculiar a date as August 6th, 1917 in the exempting proviso of Paragraph 31 (b) of the Revenue Act of October 3rd, 1917, which provides,

> "This sub-division shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

The answer to this question, it is submitted, will determine what Congress meant by the word "distribution" as used in this exempting proviso of Section 31 (b) of the Act, and, therefore, what Congress meant by the word "distribution" as used in the first part of Section 31 (b) of the Act.

This brief is filed by me on behalf of fifteen clients who are stockholders of the Harbison-Walker Refractories Company, and who have cases pending in the Courts. Harbison-Walker Refractories Company on August 3rd,

1917 declared a dividend on its common stock, payable on August 25th, 1917, and payable out of the surplus of the Company that had been accumulated prior to March 1st, 1913. Under the Internal Revenue Act of 1916 in effect at the time of the declaration of the said dividend and in effect at the time of the payment of the said dividend, and under the rules and regulations of the Commissioner of Internal Revenue in force both at the time of the said declaration and at the time of the said payment, the said dividend was not taxable as income to the stockholders of the said Company inasmuch as it had been declared out of earnings or profits accrued prior to March 1st, 1913. The Revenue Act of 1916 as amended by the Act of October 3rd, 1917, added a new provision in the law by providing in Section 31 (b):

> "(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out

of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

The question, therefore, before the courts in the said Harbison-Walker Refractories Company cases is: Was this dividend so declared on August 3rd, 1917, but payable on August 25th, 1917 out of earnings or profits accrued prior to March 1st, 1913, a distribution made prior to August 6th, within the proviso of Section 31 (b) of the Act?

THE LEGISLATIVE HISTORY OF THE ACT OF OCTOBER 3RD, 1917, CONCLUSIVELY SHOWS THAT CONGRESS INTENDED THAT A DIVIDEND DECLARED PRIOR TO AUGUST 6TH, 1917, OUT OF 1913 SURPLUS SHOULD NOT BE TAXABLE; AND THAT, THEREFORE, A DISTRIBUTION IS MADE UNDER SECTION 31 (b) OF THE ACT WHEN A DIVIDEND IS DECLARED AND NOT WHEN IT IS PAID.

The legislative history of the Act may, where the meaning of the words used is doubtful, be resorted to as an aid to construction. Surely the Governemnt cannot contend that the meaning of the words in question is not doubtful when it acquiesced in the decision of the case of the *Appeal of A. H. Strange*, 1 U. S. Board of Tax Appeals, 810, which decided that the date of the declaration of a dividend, and not the date of payment, governs its taxable status, and then the Government subsequently withdrew its acquiescence. And moreover, nearly six months after fifteen suits at law had been filed by the stockholders of the Harbison-Walker Refractories Company the Commissioner of Internal Revenue acquiesced in the legal principles therein contended for but subsequently withdrew his acquiescence. Surely the Government must admit that the meaning of the words in question is doubtful when it has reversed itself on at least two occasions.

The legislative history of the Act in question is conclusive on the intent of Congress on account of the peculiar date, August 6th, that has been inserted in the exempting proviso of Section 31 (b) of the Act. Why was this peculiar date, August 6th, adopted? Why was not the date of the passage of the Act adopted? Or why was not January 1st, 1917 adopted, thus consistently making the Act retroactive throughout as of January 1st, 1917? To understand why, it is necessary to review the income tax laws.

Under the first Income Tax Law of 1913 it was decided by the Circuit Court of Appeals in *United States v. Guinzburg,* 278 Fed., 363, that a dividend declared on February 17, 1913, but payable July 1, 1913, was a capital account on March 1, 1913, when the income tax first went into effect and that the dividend was not taxable income for 1913. Following this decision, when corporations distributed the surplus which they had accumulated prior to March 1, 1913, it was contended that the dividends received out of this surplus, even though declared and paid after March 1, 1913, were not taxable as income to the stockholders, but this contention was disputed by the Government, and rightfully, and the Supreme Court of the United States, in *Lynch v. Hornby,* 247 U. S., 339, decided that such dividends so declared and so paid after March 1, 1913, were taxable to the stockholders. However, even before the final decision of the Supreme Court in *Lynch v. Hornby,* Congress, in order to permit corporations to distribute the surplus which they had accumulated prior to March 1, 1913 as dividends that would not be subject to the income tax, provided in the Revenue Act of September 8, 1916, which was in effect until October 3, 1917, that cash dividends are taxable only if paid out of earnings accrued since March 1, 1913. Section 2 (a) of the Act provided:—

"That the terms 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen."

Immediately after this, if a corporation declared a dividend and that dividend was actually paid out of March 1, 1913 surplus, or if the Board of Directors ordered the dividend to be paid out of March 1, 1913 surplus, such a dividend was not taxable at all as income to the stockholders. Rules and regulations were issued by the Treasury Department and the Commissioner of Internal Revenue did not make the slightest effort to discourage corporations from taking full advantage of the law. Montgomery, in his Income Tax Procedure for 1918, says, at page 139:

"The law of September 8, 1916, provides that cash dividends are taxable only if paid out of earnings accrued since March 1, 1913.

"The Treasury Department ruled that cash dividends included in returns for the year 1916, were taxable, and that dividends declared out of earnings accrued prior to March 1, 1913, were not taxable, and no return at all was required as to such dividends. It was, however, held that 'the only manner in which a stockholder can omit from his return of annual net income for the year 1916, all or any part of the dividend received is for him to receive a statement from the company that all or a certain portion of the dividends was declared and paid out of surplus and undivided profits accumulated prior to March 1, 1913, and that the books of the corporation reflect such an amount.'

"The Department made no effort to restrict the payment of dividends out of surplus accrued prior to

March 1, 1913, but very properly required evidence that the corporations were keeping strict account of the disposition of the surplus at that date. This is made quite clear in a further ruling, viz:

> 'In each case where dividends are declared and paid out of surplus and profits earned prior to March 1, 1913, the corporation should specifically inform the stockholders that the dividends were declared and paid out of such surplus and profits, and proper entries must be made on the books of the corporation showing from what surplus or earnings the dividends were paid. It is immaterial to this office whether dividends are paid out of current earnings or surplus acquired prior to March 1, 1913, but for the purpose of the Federal income tax it is necessary that this office be fully advised in a return of annual net income whether or not the dividends received were paid out of surplus earned prior or subsequent to March 1, 1913.' "

Immediately after the passage of this 1916 Act corporations throughout the country declared dividends out of their March 1, 1913, surplus. Printed statements were received with the dividend checks notifying stockholders that the dividend received was declared out of March 1, 1913, surplus, and, therefore, was not taxable. This, of course, was before war was declared with Germany and before there was any thought of the tremendous increase in taxation which took place when excess profit taxes went up as high as 80%, and the tax on individuals up to 73%.

Corporations, under this 1916 Act had a right to so distribute tax free dividends and there was not even any evasion of the law or taking advantage of a technicality. They acted in good faith.

The Revenue Act of 1917, passed on October 3, 1917, changed this situation by declaring in Section 31 (b), that any distribution made to stockholders in 1917 and subsequent years shall be deemed to have been paid from the most recently accumulated undivided profits or surplus. Thus corporations had to declare dividends out of their current earnings or surplus and exhaust the same before they could declare them out of the accumulated March 1, 1913 surplus.

As passed by the House the Bill would have continued to allow corporations to distribute their March 1, 1913 surplus as tax free dividends. However, when it reached the Senate Finance Committee a change was made; and on AUGUST 6, 1917 the bill was reported out of the Finance Committee of the Senate by Senator Simmons, Chairman of the Finance Committee. The bill so reported, contained the following provision, which was the basis of Section 31 (b) of the Act as finally enacted:

> "Provided further that any distribution made to the shareholders of a corporation, joint-stock company, or association, or insurance company, in the year 1917 or subsequent tax years, shall be deemed to have been made from the net income of the year in which such distribution is made," etc. Senate Document 11 and Senate Document 74, 65th Congress, First Session.

Accompanying this Bill, so reported to the Senate, was a report of Senator Simmons, Chairman of the Committee of Finance, Senate Reports, Vol. 1, page 103, 65th Congress, First Session, in which it is stated as follows:

> "The more important amendments so recommended by your Committee are as follows:
>
> Ninth. That dividends declared and paid in the year 1917 or subsequent tax years shall be deemed to have been paid from the net income of the year in which paid or from the most recently accumulated sur-

plus, and shall constitute a part of the annual income of the stockholder for the years in which earned by the concern and the tax to be paid by the shareholders shall be at the rate prescribed by law for such years."

This report of the Finance Committee was published broadcast by the newspapers, by the Corporation Trust Company, by the New York banks and other agencies, through circular letters, and the public for the first time realized that, the Bill being retroactive as of January 1, 1917, all the distributions by corporations in 1917 under the 1916 law, made in good faith, out of the surplus existing on March 1, 1913, would not only be not non-taxable, but on the contrary they would be subject to rates of taxation never dreamed of in the history of the United States. A storm of protests arose and many protests were filed with the Conference Committee against the adoption of this report of the Senate Committee, especially the retroactive feature of making taxable these dividends declared in good faith out of March 1, 1913 surplus, when the law and the rules and regulations provided that they were not taxable. Among others protesting was Robert H. Montgomery, an attorney-at-law, a certified public accountant, an ex-President of the American Association of Public Accountants and Assistant Professor of Accounting at Columbia University and a well known authority on income tax procedure. In his book, "Income Tax Procedure, 1918," he says, at page 151:

> "The author, on behalf of clients, submitted the following memorandum to members of the *Conference Committee*:
>
> > 'Under the law of September 8, 1916, dividends declared out of surplus accrued prior to March 1, 1913, are not taxable in the hands of the recipients. The Treasury Department has

ruled that where directors specifically state that particular dividends are applicable to surplus accrued prior to March 1, 1913, and are so charged on the books, the recipients of such dividends are not liable for any tax thereon.

The pending revenue bill provides that all dividends must be charged against most recently accrued earnings, and further provides that this method applies to all dividends declared after January 1, 1917. If no change is made this will work extreme hardship to many stockholders of closely held corporations where extraordinary dividends have been declared during 1917 out of surplus accrued prior to March 1, 1913. In most cases such dividends have been paid in stock, and no change in actual condition has taken place. That is, a corporation with a small capital and a large surplus changes over to a large capital and a small surplus. No cash has been paid out; the stockholders have received nothing of value as their equity has not changed.

If the pending bill becomes a law and an attempt is made to upset the action of the directors and hold that such dividends are applicable to the earnings of 1917 or 1916, and taxes are assessed accordingly, grave injustice will result, and certain stockholders who in fact have received nothing valuable either from an accounting or a market point of view will have assessed against them enormous taxes which many will be unable to pay. The Government cannot claim that such stockholders are in a position of their own creation. On the contrary, the Government itself, by the law of 1916 and the regulations of the Treasury Department relating thereto, has directly said to such corporations and such stock-

holders, 'You may specify that dividends are applicable to surplus accrued prior to March 1, 1913, and subject to such surplus being an actual surplus at that date no income tax will be levied thereon.'

In other words the pending law is a clear violation of the Government's own policy and to penalize stockholders who innocently followed the guidance of the Government would be extremely unjust and inequitable and, while it might result in the immediate collection of a certain amount of tax, never could be defended and could hardly be expected to be sustained by the courts.

The suggestion is made that the provision as to the designation of surplus out of which dividends are declared be made operative as of the date the revenue bill becomes a law or at an early date thereafter.

The provision is not one which commends itself to the writer, but if not made retroactive no one can complain of lack of notice from the Government that the law of 1916 has been subjected to a radical change.'"

As a result of these protests, the Conference Committee, on October 2, 1917, the day before the Act was finally approved, recommended the exact language of Section 31 (b), as finally passed, containing the exempting proviso with its peculiar date of AUGUST 6, 1917, which is so clarifying to the situation and shows so conclusively that Congress intended that if a corporation in good faith acted prior to August 6, 1917, by declaring dividends out of the March 1, 1913, surplus, such dividends should not be taxable. The exempting proviso is as follows:

"This subdivision shall not apply to any distribution made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913."

Moreover, Senator Simmons, in the debate on the Bill in the Senate on October 2nd, 1917, the day it was passed, page 7615, Congressional Record, 65th Congress, First Session, further conclusively showed the intent of Congress by speaking as follows:

"Under existing law and in the House Bill the accumulated surplus of corporations when distributed, whether in cash or in stock, become subject to surtax of the stockholder receiving it unless the surplus thus distributed was accumulated prior to March 1, 1916 (1913), the date of the adoption of the income-tax amendment to the Constitution. Surplus acquired before that date is not and cannot be subject to an income tax of any kind. In this condition of the law it was clearly to the interest of the corporation to distribute its surplus accumulated before 1913 instead of that more recently accumulated.

"In order to be just to the corporations and at the same time to encourage them to distribute their annual earnings your Committee reported to the Senate and the Senate adopted an amendment providing that the surplus when distributed shall be taxed to the distribution (distributee) at the rate prescribed by law for the year in which they were earned, but also provided that any distribution of surplus made in 1917 or subsequent tax years should be deemed to have been made from the most recently accumulated undivided profits, thereby making it necessary for the corporation to distribute its surplus earned since March 1, 1913, before that earned prior to that time. (Interuption).

"The Conferees agreed to these amendments but added an amendment to the effect that the later amendment—that is to say, the one requiring the distribution to be made from the most recently acquired surplus—should not apply to any distribution made prior to

AUGUST 1 (6), 1917, out of earnings accrued prior to March 1, 1913."

Why was the date, August 6th, taken? We submit that it was not an arbitrary date, but it was the date on which the Senate Finance Committee reported the bill to the Senate, accompanied by its report, calling attention of the taxpayers in the United States to the change in the law. Montgomery, in his 1918 Income Tax Procedure, states, at page 153:

> "The date selected, viz: August 6, 1917, was the date on which the Senate Finance Committee reported the Revenue Bill as amended to the Senate. As reported, the bill indicated the intention to compel the distribution of all earnings subsequent to March 1, 1913, before the surplus at that date could be distributed. This was sufficient notice of a radical change in the 1916 law, and directors who declared dividends after August 6, 1917, were charged with a knowledge that the 1916 law would be amended."

Under this state of facts, therefore, if a corporation in good faith declared a dividend on August 3rd, 1917, was it not clearly a distribution made prior to August 6th, within the intention of Congress? The primary purpose of taking the date of August 6th was to leave undisturbed the actions of corporations that had acted in good faith prior to August 6th, but to tax the stockholders of corporations that had declared dividends out of their March 1, 1913, surplus, after the Senate Finance Committee had made its report. Senator Simmons states: "In order to be just to the corporations" conferees added the amendment to the effect that 31 (b) should not apply to any distribution made prior to August 6th. Surely it would not be *just* to corporations to make its stockholders taxable on a dividend so declared, and as we contend, "distributed" prior to August 6th, 1917.

If, therefore, a "distribution made" under the exempting proviso of 31 (b) occurs when the dividend is declared, it necessarily follows that under the first part of Section 31 (b) a distribution is made when the dividend is declared and not when it is paid.

* * * * * * * * *

The legislative history of the Income Tax Act also disposes of a point strongly urged by the Government in the case at bar. Section 31 (a) of the Act of 1917 limits the meaning of the word "dividends" not by defining the term, but by providing

> "That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen," etc.

The Government emphasizes the words "made or ordered to be made" and absolutely ignores the essential qualifying phrase, "out of its earnings and profits accrued since March 1, 1913." It then argued that inasmuch as the phrase "ordered to be made" is omitted from Section 31 (b), Congress had a deep seated purpose in this omission.

It is submitted that Section 31 (a) was literally taken from the Act of 1916, while Section 31 (b) made its first appearance in the Act of October, 1917. Section 31 (a) was, as it stated, literally taken from the Act of 1916 and its purpose, as we have above stated, was to permit corporations to distribute their accumulated March 1, 1913, surplus in non-taxable dividends. As above explained, under the first Revenue Law of 1913, *Guinzburg v. United States* held that a dividend declared before March 1st, 1913, but payable after March 1st, 1913, was not income that, under the Constitution, could be subjected to an income tax;

then the corporations attempted to distribute all their accumulated March 1st, 1913 surplus and stockholders contended that inasmuch as that surplus had been accumulated before March 1st, 1913, on its distribution by the declaration of dividends after March 1st, 1913, they were not taxable. Various suits arose and finally Congress, in the Revenue Act of 1916, put to rest the matter, not by defining dividends but by limiting taxable dividends to those distributed from surplus earned since March 1, 1913. Section 2 (a) of the Act of 1916 provided:

> "That the term 'dividends,' as used in this title, shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen."

These are the words that changed the law completely and permitted corporations to distribute their dividends out of March 1st, 1913 surplus. If (a) a corporation had nothing but March 1st, 1913 surplus at the time of distribution such dividend would not be "any distribution made * * * out of its earnings or profits accrued since March 1, 1913"; or (b) if a corporation having both current earnings and March 1st, 1913 surplus declared a dividend and "ordered" the distribution made out of March 1st, 1913 surplus, then such a dividend would not be a "distribution * * * ordered to be made by a corporation * * * out of its earnings or surplus accrued since March 1st, 1913"; therefore neither dividend would be taxable income to the stockholders.

The words of the 1917 Act in Section 31 (a) are absolutely identical with this important provision of the 1916 Act. This Section 31 (a), which the Government calls a definition, but which we submit is a limitation

of the meaning of the word "dividends," which originated in the 1916 law, was continued in the 1917 law to provide for the corporations that had made distributions prior to August 6th, 1917, and also for the cases where a corporation, even after August 6th, 1917, exhausted its current earnings and resorted to the distribution of dividends out of the March 1st, 1913 surplus. That this was the purpose and meaning of Section 2 (a) of the Revenue Act of 1916 and of Section 31 (a) of the Revenue Act of 1917 was shown by the remarks of Mr. Justice Pitney in the case of *Lynch v. Hornby,* 247 U. S., 339, where, at page 345, he says:

> "In the more recent income tax acts, provisions have been inserted for the purpose of excluding from the effect of the tax any dividends declared out of earnings or profits that accrued prior to March 1st, 1913. This *originated* with the Act of September 8th, 1916, and has been *continued* in the Act of October 3rd, 1917." (Italics ours.)

The note by the Supreme Court is as follows:

> "In Act of September 8, 1916 (Chap. 463, 39 Stat. at L. 756, 757, Comp. Stat. 1916 §6336a, 6336b), which took the place of the Act of 1913, the substance of what we have quoted from ¶ B of the 1913 Act was embodied in §2 (a), but with this proviso: 'Provided, that the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * *out of its earnings or profits accrued since March first, nineteen hundred and thirteen,* and payable to its shareholders, whether in cash or in stock of the corporation,' etc. And by the Act of October 3, 1917 (chap. 63, 40 Stat. at L. 300, 329, 337, 338), §2 (a) of the 1916 Act was amended by being repeated without the proviso (p. 329), while the proviso was inserted as a new section—31 (a)—

and to it was added a subsection, (b), as follows:" The Supreme Court then copies Section 31 (b) of the Act of 1917. (The italics are by the Supreme Court.)

We submit, therefore, that the words "made or ordered to be made," are wrongly interpreted by the Government. They positively do not refer to two periods of time, as the Government contends, but they clearly refer to two different sets of facts; namely, (a) if the corporation had only March 1st, 1913 surplus, a distribution out of it was not a taxable dividend, or (b) if a corporation having current earnings and March 1st, 1913 surplus, "ordered" the distribution to be made out of the 1913 surplus, it was not a taxable dividend. This clearly refers to two states of fact—and not to two periods of time, as the Government is contending by trying to make a distinction between the date of the declaration of a dividend and the time of the payment of a dividend. Granting that this was the intent of Congress in limiting the word "dividends" as used in Section 31 (a), (and Justice Pitney says that that was the intent of Congress) then there would be no object or purpose in putting the words "ordered to be made" in Section 31 (b), because the primary purpose of Section 31 (b) was to deprive corporations of the power of "ordering" distributions to be made out of any particular surplus. It required distribution subsequent to January 1, 1917, to be made out of current earnings, except in the case of distributions falling within the proviso.

* * * * * * * * *

In conclusion, it is submitted that a mere statement of the facts in chronological order leading up to the enactment of this proviso shows conclusively that Congress intended that a dividend declared before August 6th, 1917 out of March 1st, 1913 surplus, was a "distribution made before August 6th, 1917"; that Congress, by adopting the

date August 6th, 1917, did intend to keep faith with a corporation which, bona fide, had taken action by declaring a dividend before August 6th, 1917, even though such dividend was payable after this date. Briefly, the facts in chronological order are as follows: (a) The Act of 1916, in effect until October 3rd, 1917, which expressly permitted a corporation to declare non-taxable dividends out of surplus existing as of March 1st, 1913; (b) The introduction of the Bill which finally became the Act of October 3rd, 1917, which Bill permitted a corporation to continue to declare such non-taxable dividends; (c) The report made public on AUGUST 6TH, 1917, of the Finance Committee, setting forth its recommendations to prohibit this practice and to compel dividends to be paid out of current earnings; (d) The protest filed against interfering with the bona fide action of corporations already taken during the year 1917 in declaring such non-taxable dividends; (e) The specific request or suggestion by Montgomery, that the proposed change in the law should be made operative as of the date of the passage of the Bill; (f) The insertion in the Bill, on October 2nd, 1917, the day of its passage, of this significant date, AUGUST 6TH, 1917; (g) The remarks by Senator Simmons, Chairman of the Finance Committee, on October 2nd, 1917, that "in order to be just to the corporations" an amendment was adopted making dividends payable out of current earnings, but that this amendment should not apply to any distribution made prior to AUGUST 6TH, 1917, out of earnings accrued prior to March 1st, 1913.

Surely Congress intended that in order "to be just to the corporation" its action should be judged as of the date when it declared a dividend, and not when it paid it.

Respectfully submitted,

JAMES E. MACCLOSKEY, JR.,
Amicus Curiae.

Office Supreme Court, U. S.
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No. 152

IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

F. H. MASON,

Petitioner,

against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio,

Respondent.

CHARLES E. HUGHES,
HARRISON TWEED,
of Counsel.

S. M. JETT,
HORACE ANDREWS,
Counsel for Petitioner.